Time Warner Telecom Inc.

Index to Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Time Warner Telecom, Inc.

We have audited the accompanying consolidated balance sheets of Time Warner Telecom, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed at page F-1. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Time Warner Telecom, Inc. at December 31, 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Time Warner Telecom, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Denver, Colorado
March 14, 2005

TIME WARNER TELECOM INC.

CONSOLIDATED BALANCE SHEETS
December 31, 2004 and 2003

	2004	2003
	(amounts in thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 130,052	353,032
Investments (note 2)	302,454	125,561
Receivables, less allowances of $11,415 and $15,011, respectively (a)	45,557	42,969
Prepaid expenses and other current assets	13,088	10,511
Deferred income taxes (note 5)	12,510	22,414
Total current assets	503,661	554,487
Property, plant and equipment	2,336,338	2,215,523
Less accumulated depreciation	(1,033,246)	(852,276)
	1,303,092	1,363,247
Deferred income taxes (note 5)	46,267	36,060
Goodwill	26,773	26,773
Other assets, net of accumulated amortization (note 1)	25,795	25,316
Total assets	$ 1,905,588	2,005,883
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable (b)	$ 42,504	40,096
Deferred revenue	20,229	29,053
Accrued taxes, franchise and other fees	69,001	72,951
Accrued interest	44,265	35,078
Accrued payroll and benefits	23,209	28,402
Accrued carrier costs	51,056	61,459
Current portion debt and capital lease obligations (notes 3 and 7)	1,387	525
Other current liabilities	30,089	30,650
Total current liabilities	281,740	298,214
Long-term debt and capital lease obligations (notes 3 and 7)	1,249,197	1,203,383
Other long-term liabilities	7,493	6,487
Stockholders' equity:		
Preferred stock, $0.01 par value, 20,000,000 shares authorized, no shares issued and outstanding	—	—
Class A common stock, $0.01 par value, 277,300,000 shares authorized, 49,868,947 and 49,355,252 shares issued and outstanding in 2004 and 2003, respectively	499	493
Class B common stock, $0.01 par value, 162,500,000 shares authorized, 65,936,658 shares issued and outstanding in 2004 and 2003	659	659
Additional paid-in capital	1,172,440	1,169,633
Accumulated other comprehensive income, net of taxes	—	417
Accumulated deficit	(806,440)	(673,403)
Total stockholders' equity	367,158	497,799
Total liabilities and stockholders' equity	$ 1,905,588	2,005,883
(a) Includes receivables resulting from transactions with affiliates (note 4)	$ 1,997	4,332
(b) Includes payables resulting from transactions with affiliates (note 4)	$ 8,844	6,092

See accompanying notes

TIME WARNER TELECOM INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2004, 2003, and 2002

	2004	2003	2002
	(amounts in thousands, except per share amounts)		
Revenue (a):			
Dedicated transport services	$ 332,577	361,038	373,928
Switched services	157,905	152,789	146,304
Data and Internet services	124,805	104,576	90,293
Intercarrier compensation	37,800	51,188	85,049
Total revenue	653,087	669,591	695,574
Costs and expenses (b):			
Operating	261,285	264,322	279,351
Selling, general and administrative	178,317	172,925	227,007
Depreciation, amortization, and accretion	230,688	223,904	237,310
Impairment of assets	—	—	212,667
Total costs and expenses	670,290	661,151	956,335
Operating income (loss)	(17,203)	8,440	(260,761)
Interest expense	(122,391)	(103,642)	(107,279)
Interest income	6,483	5,858	5,845
Investment gains(losses), net	710	3,994	(3,240)
Loss before income taxes and cumulative effect of change in accounting principle	(132,401)	(85,350)	(365,435)
Income tax expense (note 5)	636	1,021	600
Net loss before cumulative effect of change in accounting principle	(133,037)	(86,371)	(366,035)
Cumulative effect of change in accounting principle (note 1)	—	2,965	—
Net loss	$(133,037)	(89,336)	(366,035)
Amounts per common share, basic and diluted:			
Loss before cumulative effect of change in accounting principle	$ (1.15)	(0.75)	(3.19)
Cumulative effect of change in accounting principle (note 1)	—	(0.03)	—
Net loss	$ (1.15)	(0.78)	(3.19)
Weighted average shares outstanding, basic and diluted	115,665	114,998	114,786
(a) Includes revenue resulting from transactions with affiliates (note 4)	$ 19,866	33,378	31,757
(b) Includes expenses resulting from transactions with affiliates (note 4):			
Operating	$ 4,746	3,685	2,630
Selling, general and administrative	$ 2,176	1,894	1,041

See accompanying notes

TIME WARNER TELECOM INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2004, 2003, and 2002

	2004	2003	2002
	(amounts in thousands)		
Cash flows from operating activities:			
Net loss	$(133,037)	(89,336)	(366,035)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation, amortization, and accretion	230,688	223,904	237,310
Cummulative effect of change in accounting principle	—	2,965	—
Amortization of deferred debt issue costs	4,417	4,514	4,575
Impairment of assets related to restructure charge	—	—	(694)
Impairment of deferred debt issue costs	8,437	—	1,951
Investment (gains) losses, net	(710)	(3,994)	3,240
Impairment of Assets	—	—	212,667
Stock based compensation	1,164	1,481	1,595
Changes in operating assets and liabilities, net of the effect of acquisitions:			
Receivables and other assets	(8,358)	17,490	18,662
Accounts payable	(1,447)	1,177	(45,072)
Accrued interest	10,148	(591)	(1,961)
Accrued payroll and benefits	(5,193)	(2,639)	3,033
Other current liabilities	(19,568)	(31,154)	(5,464)
Accrued restructure costs	—	(196)	(2,241)
Net cash provided by operating activities	86,541	123,621	61,566
Cash flows from investing activities:			
Capital expenditures	(167,829)	(129,697)	(104,831)
Purchases of investments	(546,948)	(260,508)	(8,546)
Proceeds from maturities of investments	373,155	134,947	27,000
Proceeds from sale of assets	784	176	2,412
Proceeds from sale of investments	752	4,397	—
Other investing activities	1,316	—	—
Net cash used in investing activities	(338,770)	(250,685)	(83,965)
Cash flows from financing activities:			
Net proceeds from issuance of debt	—	—	216,770
Repayment of debt	—	(24,000)	(50,000)
Net proceeds from issuance of common stock upon exercise of stock options	686	806	145
Net proceeds from issuance of common stock in connection with the employee stock purchase plan	963	285	222
Retirement of debt obligations	(396,000)	—	—
Net proceeds from issuance of debt	425,858	—	—
Payment of capital lease obligations	(2,258)	(3,455)	(3,878)
Net cash (used in) provided by financing activities	29,249	(26,364)	163,259
(Decrease) increase in cash, cash equivalents, and cash held in escrow	(222,980)	(153,428)	140,860
Cash, cash equivalents, and cash held in escrow at beginning of year	353,032	506,460	365,600
Cash, cash equivalents, and cash held in escrow at end of year	$ 130,052	353,032	506,460
Supplemental disclosures of cash flow information:			
Cash paid for interest	$ 103,027	101,393	105,141
Tax benefit related to exercise of non-qualified stock options	$ —	(700)	—
Cash paid for income taxes	$ 702	1,332	967
Cancellation of capital lease obligation	$ —	3,194	1,507
Addition of capital lease obligation	$ 4,004	2,152	—

See accompanying notes

TIME WARNER TELECOM INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2004, 2003, and 2002

	Common Stock				Additional paid-in capital	Accumulated other comprehensive income (loss), net of taxes	Accumulated deficit	Total stockholders' equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
					(amounts in thousands)			
Balance at January 1, 2002	48,789	$488	65,937	$659	1,165,804	(206)	(218,032)	948,713
Change in unrealized holding gain for available-for-sale securities, net of taxes	—	—	—	—	—	595	—	595
Net loss	—	—	—	—	—	—	(366,035)	(366,035)
Comprehensive loss	—	—	—	—	—	—	—	(365,440)
Shares issued for cash in connection with the exercise of stock options	10	—	—	—	145	—	—	145
Shares issued for cash in connection with the employee stock purchase plan	167	1	—	—	221	—	—	222
Stock-based compensation	25	—	—	—	1,595	—	—	1,595
Balance at December 31, 2002	48,991	$489	65,937	$659	1,167,765	389	(584,067)	585,235
Change in unrealized holding gain for available-for-sale securities, net of taxes	—	—	—	—	—	28	—	28
Net loss	—	—	—	—	—	—	(89,336)	(89,336)
Comprehensive loss	—	—	—	—	—	—	—	(89,308)
Shares issued for cash in connection with the exercise of stock options	214	2	—	—	104	—	—	106
Shares issued for cash in connection with the employee stock purchase plan	150	2	—	—	283	—	—	285
Stock-based compensation	—	—	—	—	1,481	—	—	1,481
Balance at December 31, 2003	49,355	$493	65,937	$659	1,169,633	417	(673,403)	497,799
Change in unrealized holding gain for available-for-sale securities, net of taxes	—	—	—	—	—	(417)	—	(417)
Net loss	—	—	—	—	—	—	(133,037)	(133,037)
Comprehensive loss	—	—	—	—	—	—	—	(133,454)
Shares issued for cash in connection with the exercise of stock options	230	3	—	—	683	—	—	686
Shares issued for cash in connection with the employee stock purchase plan	200	2	—	—	961	—	—	963
Forfeiture of restricted stock	(11)	—	—	—	—	—	—	—
Stock-based compensation	95	1	—	—	1,163	—	—	1,164
Balance at December 31, 2004	49,869	$499	65,937	$659	1,172,440	—	(806,440)	367,158

See accompanying notes

TIME WARNER TELECOM INC.

NOTES TO CONSOLIDATED AND CONDENSED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Description of Business and Capital Structure

Time Warner Telecom Inc. (the "Company"), a Delaware corporation, is a leading provider of managed network solutions to business customers in 44 metropolitan markets in the United States. The Company delivers data, dedicated Internet access, and local and long distance voice services.

The Company has two classes of common stock outstanding, Class A common stock and Class B common stock. Holders of Class A common stock have one vote per share, and holders of Class B common stock have ten votes per share. Each share of Class B common stock is convertible, at the option of the holder, into one share of Class A common stock. Currently the Class B common stock is collectively owned directly or indirectly by Time Warner Inc. ("Time Warner"), Advance Telecom Holdings Corporation and Newhouse Telecom Holdings Corporation ("Advance/Newhouse") (collectively, the "Class B Stockholders"). Holders of Class A common stock and Class B common stock generally vote together as a single class. However, some matters require the approval of 100% of the holders of the Class B common stock voting separately as a class, and some matters require the approval of a majority of the holders of the Class A common stock, voting separately as a class. As of December 31, 2004, the Class B Stockholders had approximately 93% of the combined voting power of the outstanding common stock and were represented by five members of the Board of Directors.

The Company also is authorized to issue shares of Preferred Stock. The Company's Board of Directors has the authority to establish voting powers, preferences, and special rights for the Preferred Stock. No such voting powers, preferences, or special rights have been established and no shares of Preferred Stock have been issued as of December 31, 2004.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and all entities in which the Company has a controlling voting interest ("subsidiaries"). Significant intercompany accounts and transactions have been eliminated. Significant accounts and transactions with Time Warner, Advance/Newhouse and their affiliates are disclosed as related party transactions.

Cash Equivalents

The Company considers all highly liquid debt instruments with an original maturity of three months or less, when purchased, to be cash equivalents.

Investments

Marketable equity securities held by the Company were classified as available-for-sale. Accordingly, marketable equity securities were included in other assets at fair value. Unrealized holding gains and losses on equity securities classified as available-for-sale were carried, net of taxes, as a component of accumulated other comprehensive income in stockholders' equity. Other equity investments which were not considered marketable securities and in which the Company's ownership interest was less than 20% were generally carried at the lower of cost or net realizable value. Realized gains and losses are determined on a specific identification basis.

As of December 31, 2004, the Company had sold its remaining shares of marketable equity securities. For the twelve months ended December 31, 2004, the sale of securities yielded a gain of $710,000 and proceeds of $752,000.

Marketable debt securities are classified as held-to-maturity as the Company has the intent and ability to hold the securities to maturity. Held-to-maturity securities are carried at amortized cost, which was $429 million at December 31, 2004. The fair value of marketable debt securities is not materially different than the amortized cost.

During the year ended December 31, 2002, the Company recognized a net loss of $3.2 million on investments. The net loss included $2.7 million in losses related to marketable securities whose decline in value was not temporary in nature and a $1.0 million impairment on an equity investment in a non-public company that is not considered a marketable security. These losses were partially offset by a $400,000 gain on the exchange of shares in a privately held company for shares in a publicly held company.

During 2002 and 2001, the Company recognized aggregate $6.6 million impairment on equity investments. The impairment charges represent the difference between historical prices of the investments and their estimated fair value as of the date of financial statements. The Company recorded these charges based on its conclusion that the investee companies had not executed their business plans as originally anticipated, in part due to the adverse economic conditions surrounding the telecommunications and technology sectors during 2001 and 2002, and had conducted further financing activities that diluted the value of the Company's investments. The subsequent financing activities at these companies served as independent indicators that the impairment was not temporary. The estimates of net realizable value were primarily derived from the financing activities at these companies.

Receivables

The Company performs ongoing credit evaluations of significant customers' financial conditions and has established an allowance for doubtful accounts based on the expected collectability of all receivables. In certain cases, the Company requires deposits from customers that it deems to represent a higher credit risk. A higher risk of collectability is assigned to certain customers with deteriorating financial conditions and customers in bankruptcy that continue service subsequent to filing bankruptcy, resulting in a greater allowance for doubtful accounts. Considerable management judgment is required in evaluating the collectability of receivables and establishing the related allowance for doubtful accounts. If the financial condition of the Company's customers deteriorates, the Company's bad debt expense and cash collections will be negatively impacted. The allowance for doubtful accounts was $11.4 million, or 20% of gross receivables at December 31, 2004, and $15.0 million, or 26% of gross receivables at December 31, 2003.

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Construction costs, labor, applicable overhead related to the development, installation, and expansion of the Company's networks, and interest costs related to construction are capitalized. Capitalized labor and applicable overhead was $30.8 million, $21.7 million, and $25.4 million for 2004, 2003, and 2002, respectively. Capitalized interest was $2.7 million, $1.3 million, and $2.7 million for 2004, 2003, and 2002, respectively. Repairs and maintenance costs are charged to expense when incurred. The Company disposes of assets which are no longer in use, losses on such disposals are included as a component of depreciation expense and were $7.3 million, $5.6 million and $3.5 million in 2004, 2003, and 2002, respectively.

The Company licenses the right to use fiber optic capacity in 23 of its 44 markets from Time Warner Cable. The cost of these rights, which are prepaid by the Company, is capitalized and reflects an allocable share of Time Warner Cable's costs, which prior to July 1998, generally reflected the incremental costs incurred by Time Warner Cable to construct the fiber for the Company. Subsequent to July 1998, the Company pays its allocable share of the cost of fiber and construction incurred by Time Warner Cable in routes where the parties are in joint construction.

Depreciation is provided on the straight-line method over estimated useful lives as follows:

Buildings and improvements	10-20 years
Communications networks	5-15 years
Vehicles and other equipment	3-10 years
Fiber optics and right to use	15 years

Depreciation expense was $229.6 million, $222.9 million, and $237.2 million in 2004, 2003, and 2002, respectively.

Property, plant, and equipment consist of:

	December 31,	
	2004	2003
	(amounts in thousands)	
Land, buildings and improvements	$ 62,318	63,513
Communications networks	1,486,273	1,420,230
Vehicles and other equipment	158,658	152,744
Fiber and right to use (Note 4)	629,089	579,036
	2,336,338	2,215,523
Less accumulated depreciation	(1,033,246)	(852,276)
Total	$ 1,303,092	1,363,247

Goodwill

The Company's goodwill was primarily generated from acquisitions completed in 1999. In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 141, *Business Combinations* ("SFAS 141"), and Statement No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"). SFAS 141 requires companies to reflect intangible assets apart from goodwill and supersedes previous guidance related to business combinations. SFAS 142 eliminates amortization of goodwill and amortization of all intangible assets with indefinite useful lives. However, SFAS 142 requires the Company to perform impairment tests at least annually on all goodwill and indefinite-lived intangible assets. These statements were adopted by the Company on January 1, 2002 and, as required, the Company completed its transitional impairment test as of January 1, 2002 and its annual impairment test are completed in the fourth quarter of each year. The adoption of the statements did not negatively impact the Company's financial position, results of operations, or cash flows.

Other Assets

Other assets primarily include deferred debt issuance costs which are amortized to interest expense over the life of their respective debt agreements.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying amounts of property, plant, and equipment and its identifiable intangible assets to determine whether current events or circumstances warrant adjustments to the carrying amounts. If an impairment adjustment is deemed necessary (generally when the net book value of an asset exceeds the expected future undiscounted cash flows to be generated by that asset or group of assets), the loss is measured by the amount that the carrying value of the assets exceeds their fair value. Considerable management judgment is necessary to estimate the fair value of assets; accordingly, actual results could vary significantly from estimates. Assets to be disposed of are carried at the lower of their carrying amount or fair value less costs to sell.

On January 1, 2002, the Company adopted FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). In the fourth quarter of 2002, the Company recorded a $212.7 million impairment charge pursuant to SFAS 144. The non-cash impairment charge primarily relates to the long haul network acquired from GST in January 2001, and, to a lesser degree, certain other local network assets. The Company acquired the assets from GST to increase its market presence in the western United States. The acquisition included networks in 15 local markets and a 4,210-mile regional network. Since the time of the acquisition, over capacity in the long haul sector and a weaker economy led to decreased demand and significant price erosion surrounding inter-city transport services. The Company generates revenue from these networks and will continue to do so in the future. The impairment reflects slower than expected growth in cash flows. The $212.7 million charge represents the difference between the estimated fair value of the assets on a discounted cash flow basis and their then current carrying values. Significant estimates and assumptions used to value these assets include estimates of future revenue growth, margin, and future investment in property, plant, and equipment.

Revenue

The Company's revenue is derived primarily from business communications services, including dedicated transport, local switched, long distance, data and Internet access services, and intercarrier compensation, which is comprised of reciprocal compensation and switched access services. The Company's customers are principally telecommunications-intensive businesses, long distance carriers, Internet service providers ("ISPs"), wireless communications companies, incumbent local exchange carriers ("ILECs"), competitive local exchange carriers ("CLECs"), and governmental entities.

Revenue for dedicated transport, data, Internet, and the majority of switched services is generally billed in advance on a fixed rate basis and recognized over the period the services are provided. Revenue for the majority of switched access services and long distance is generally billed on a transactional basis determined by customer usage with some fixed rate elements. The transactional elements of switched services are billed in arrears and estimates are used to recognize revenue in the period earned.

The Company evaluates whether receivables are reasonably assured of collection based on certain factors, including the likelihood of billing being disputed by customers. In situations where a dispute is likely, revenue is not recognized until cash is collected.

Reciprocal compensation is an element of intercarrier compensation revenue that represents compensation from local exchange carriers ("LECs") for local exchange traffic originated on another LEC's facilities and terminated on the Company's facilities. The Company recognizes reciprocal compensation revenue primarily on a cash basis except in those cases where the revenue is under dispute or at risk, in which case the Company defers recognition of the revenue until the outstanding issues are resolved. The Company utilizes the cash basis because changes in, and interpretations of, regulatory rulings create disputes and often result in significant delays in payments. The Company recognized $3.9 million, and $19.1 million, respectively, in settlements of reciprocal compensation disputes in 2003 and 2002, respectively. Reciprocal compensation represented 3%, 4%, and 7% of revenue during the years ended December 31, 2004, 2003, and 2002, respectively. Reciprocal compensation rates are established by interconnection agreements between the parties based on federal and state regulatory and judicial rulings. A 2001 Federal Communications Commission ("FCC") ruling on reciprocal compensation for ISP-bound traffic reduced reciprocal compensation rates and capped the number of minutes for which ISP-bound traffic can be compensated. Reciprocal compensation rates were further reduced in 2003. The Company pays reciprocal compensation expense to the other LECs for local exchange traffic it terminates on the LEC's facilities. These costs are recognized as incurred.

Switched access is also an element of intercarrier compensation revenue and represents the connection between a long distance carrier's point of presence and an end-user's premises provided through the Company's switching facilities. Historically, the FCC has regulated the access rates imposed by the ILECs, while the access rates of CLECs have been less regulated. Effective June 2001, the FCC began regulating CLECs' interstate switched access charges. Pursuant to the FCC's order, the Company's rates were reduced and continued to decline, through June 2004, to parity with the ILEC rates competing in each area. In addition, when a CLEC enters a new market, its access charges may be no higher than the ILEC's. The CLEC access charge regulation and related regulatory developments resulted in reductions in the per-minute rates the Company receives for switched access service. There were further recuctions beginning in June 2004. The Company expects that switched access revenue will continue to decline as a percentage of revenue due to anticipated rate reductions. There is no assurance that the Company will be able to compensate for reductions in switched access revenue with revenue from other sources. Switched access revenue represented 3%, 4%, and 5% of total revenue in 2004, 2003, and 2002, respectively.

Significant Customers

The Company has substantial business relationships with a few large customers, including major long distance carriers. The Company's top 10 customers accounted for 33%, 39%, and 45% of the Company's consolidated revenue for the years ended December 31, 2004, 2003, and 2002, respectively. MCI (Formerly "WorldCom, Inc."), which filed for Chapter 11 bankruptcy protection in July 2002, accounted for 5%, 8%, and 11% of the Company's total revenue during 2004, 2003, and 2002, respectively. In September 2003, as part of the MCI bankruptcy proceedings, MCI and the Company entered into a settlement that resolved a number of open disputes and claims through June 30, 2003, including amounts payable to and from each party. As a result of the settlement, the Company recognized $7.4 million of previously deferred revenue and reversed $15.1 million in expenses in 2003 that had been previously recorded because of uncertainties created by the bankruptcy process. In addition, both parties agreed on a claim related to MCI's rejection of certain contracts. In 2003, the Company monetized and recognized as revenue this claim by selling it to a third party for approximately $6.9 million in cash. The balance of these disputes and claims were resolved in the first quarter of 2004, resulting in recognition of $2.3 million in previously deferred revenue and a reduction of $0.4 million of expense. No customer accounted for 10% or more of total revenue in 2004, 2003, or 2002.

Income Taxes

As of December 31, 2004, the Company has recorded a deferred tax asset of $58.8 million, net of a valuation allowance of $233.3 million. The Company has concluded that it is more likely than not that the net deferred tax asset of $58.8 million will be realized because the Company could utilize tax-planning strategies in the event its net operating losses were to expire. However, the Company believes there may be risks in realizing amounts in excess of the $58.8 million through utilization of available tax planning strategies. Accordingly, the Company has established a valuation allowance for amounts in excess of $58.8 million.

Asset Retirement Obligations

Effective January 1, 2003, the Company adopted the provisions of FASB Statement No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"). SFAS 143 requires that the estimated fair value of an asset retirement obligation be recorded when incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset's estimated useful life. The Company has asset retirement obligations related to decommissioning of electronics in leased facilities and the removal of certain fiber and conduit systems. Considerable management judgment is required in estimating these obligations. Important assumptions include estimates of retirement costs, the timing of the future retirement activities, and the likelihood of retirement provisions being enforced. Changes in these assumptions based on future information could result in adjustments to estimated liabilities.

In conjunction with the adoption of SFAS 143, the Company recorded a $5.9 million liability, an asset of $2.9 million in property, plant, and equipment, and a $3.0 million charge to earnings to account for the cumulative effect of the depreciation and accretion expense that would have been recorded had SFAS 143 been in effect in earlier periods. The asset retirement obligation increased due to the accretion of the liability and the recording of additional asset retirement obligations as they occur, and was $7.5 million and $6.5 million as of December 31, 2004 and 2003, respectively. The pro forma effects of the application of SFAS 143 as if the statement had been in effect in earlier periods are presented below:

	Year Ended December 31,		
	2004	2003	2002
	(amounts in thousands, except share amounts)		
Actual loss, as reported	$(133,037)	(89,336)	(366,035)
Add back cumulative effect of change in accounting principle	—	2,965	—
Less depreciation and accretion expense	—	—	(904)
Pro forma loss	$(133,037)	(86,371)	(366,939)
Pro forma loss per share	$ (1.15)	(0.75)	(3.20)

The pro forma asset retirement obligation as if SFAS 143 had been in effect in earlier periods is $5.9 million as of December 31, 2002.

Segment Reporting

As of December 31, 2004, the Company operated in 44 service areas. The Company's management makes decisions on resource allocation and assesses performance based on total revenue, expenses, and capital spending of these operating locations. Each of the service areas offers the same services, has similar customers and networks, and are regulated by the same type of authorities, and are managed directly by the Company's executives, allowing the 44 service areas to be aggregated, resulting in one reportable line of business.

Loss Per Common Share and Potential Common Share

The Company computes loss per common share in accordance with the provisions of FASB Statement No. 128, *Earnings Per Share*, which requires companies with complex capital structures to present basic and diluted earnings per share ("EPS"). Basic EPS is measured as the income or loss available to common stockholders divided by the weighted average outstanding common shares for the period. Diluted EPS is similar to basic EPS but presents the dilutive effect on a per share basis of potential common shares (*e.g.*, convertible securities, stock options, etc.) as if they had been converted at the beginning of the periods presented. Potential common shares that have an anti-dilutive effect (*e.g.*, those that increase income per share or decrease loss per share) are excluded from diluted EPS.

Basic loss per share for all periods presented herein was computed by dividing the net loss by the weighted average shares outstanding for the period.

The diluted loss per common share for all periods presented was computed by dividing the net loss attributable to common shares by the weighted average common shares outstanding for the period. Potential common shares related to stock options were not included in the computation of weighted average shares outstanding because their inclusion would be anti-dilutive.

Options to purchase 19.2 million, 18.6 million and 17.4 million shares of the Company's Class A common stock outstanding at December 31, 2004, 2003, and 2002, respectively, were excluded from the computation of weighted average shares outstanding because their inclusion would be anti-dilutive.

Stock Option Accounting

The Company has elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of the Company's employee stock options is generally equal to the market price of the underlying stock on the date of the grant, no compensation expense is recognized. Statement No. 123, *Accounting and Disclosure of Stock-Based Compensation* ("SFAS 123"), establishes an alternative method of expense recognition for stock-based compensation awards to employees based on fair values. The Company elected not to adopt SFAS 123 for expense recognition purposes.

Pro-forma information regarding net income and earnings per share is required by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 3.1% in 2004 and 2003 and 3.0% in 2002, respectively; dividend yield of 0.0% during each period; volatility factor of the expected market price of the Company's common stock of 1.14, 1.20, and 1.26, as of December 31, 2004, 2003, and 2002, respectively; and a weighted-average expected life of the option of five years during each period.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including expected stock price characteristics significantly different from those of traded options. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's employee stock options.

The weighted-average fair value of options granted during 2004, 2003, and 2002 was $4.78, $6.06, and $2.14, respectively. For purposes of pro-forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro-forma net loss and pro-forma net loss per share, as if the Company had used the fair value accounting provisions of SFAS 123, are shown below:

	Years ended December 31,		
	2004	2003	2002
	(amounts in thousands, except per share amounts)		
Net loss	$(133,037)	(89,336)	(366,035)
Expense calculated under APB 25	—	438	525
Expense calculated under SFAS 123	(36,303)	(58,390)	(68,490)
Pro forma net loss	$(169,340)	(147,288)	(434,000)
Pro forma basic and diluted loss per share	$ (1.46)	(1.28)	(3.78)

In December 2004, the FASB issued Statement No. 123R, *Share-Based Payments*, ("SFAS 123R"). The statement is effective for the Company as of July 1, 2005. The statement requires recognition of compensation cost in financial statements for all share-based payments (including employee stock options) at fair value. SFAS 123R applies to all future grants, as well as the unamortized expense as of June 30, 2005 related to existing grants. As of December 31, 2004, the Company had approximately $20 million of unamortized expense related to existing stock option grants that will be recognized over the remaining vesting period of up to 4 years, beginning in the 3rd fiscal quarter of 2005.

The Company is currently evaluating its total compensation strategy, including the use of stock-based compensation. The Company may choose to employ compensation vehicles other than stock options in the future as part of its overall strategy. The Company's stock option expense under SFAS 123 as disclosed in the pro-forma disclosure has a significant pro-forma impact to its results of operations and has been impacted by the high volatility of the Company's stock price. The Company cannot yet quantify the impact SFAS 123R will have to its results of operations in the future since this will depend on the Company's equity compensation strategy, number of shares granted and the volatility of its stock price.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Areas that require significant management judgments include taxes, revenue and receivables, impairment of long-term assets, regulatory fees, and carrier liabilities. Changes were made to these estimates during the year, however, the impact to the financial statements was immaterial.

Reclassifications

Certain prior year amounts have been reclassified for comparability with the 2004 presentation.

2. Investments

The Company's investments portfolio includes shares of money market mutual funds and corporate and municipal debt securities. All of the Company's investments are categorized as "held-to-maturity" and carried at amortized cost.

Investments are summarized as follows:

	December 31, 2004	December 31, 2003
	(amounts in thousands)	
Cash equivalents:		
Shares of money market mutual funds	$ 7,459	8,712
Corporate and municipal debt securities	119,053	326,684
Total cash equivalents	126,512	335,396
Marketable debt securities—corporate and municipal debt and treasury notes	302,454	125,561
Total marketable debt securities	$428,966	460,957

The estimated fair value of the marketable debt securities is not materially different from the amortized cost.

3. Long-Term Debt

See Note 11 for a discussion of subsequent financing activities. The information presented below is as of December 31, 2004.

	December 31,	
	2004	2003
	(amounts in thousands)	
9¾% Senior Notes due 2008	$ 400,000	400,000
10⅛% Senior Notes due 2011	400,000	400,000
Second Priority Senior Secured Floating Rate Notes due 2011	240,000	—
9¼% Senior Notes due 2014	200,000	—
Credit facility	—	396,000
Total Long-term debt	$1,240,000	1,196,000

The schedule of principal payments on long-term debt as of December 31, 2004 is as follows (amounts in thousands):

2005	$ —
2006	—
2007	—
2008	400,000
2009	—
Thereafter	840,000
Total payments	$1,240,000

In conjunction with an amendment to its Credit Facility in 2002, the Company increased its borrowings under the Credit Facility to a total of $420 million by drawing down the $220 million in senior delayed draw loan facilities that would have expired January 10, 2003, and repaying $50 million of the $250 million term loan B. In connection with the reduction in total amount of borrowings available under the Credit Facility, the Company recorded a $2.0 million impairment of deferred financing costs as a component of interest expense.

The $400 million principal amount 9¾% Senior Notes due July 2008 (the "9¾% Senior Notes") are unsecured, unsubordinated obligations of the Company. Interest on the 9¾% Senior Notes is payable semi-annually on January 15 and July 15. Interest expense, including amortization of deferred debt issue costs relating to the 9¾% Senior Notes, totaled approximately $40.1 million for the year ended December 31, 2004 and $40.2 million for each of the years ended December 31, 2003 and 2002. At December 31, 2004, the fair market value of the $400 million of 9¾% Senior Notes was approximately $406 million. These notes have not been listed on any securities exchange or inter-dealer automated quotation system, so the estimated market value is based on indicative pricing published by investment banks. While the Company believes these approximations to be reasonably accurate at the time published, indicative pricing can vary widely depending on volume traded by any given investment bank and other factors.

The $400 million principal amount 10⅛% Senior Notes due February 2011 (the "10⅛% Senior Notes") are unsecured, unsubordinated obligations of the Company. Interest on the 10⅛% Senior Notes is payable semi-annually on February 1 and August 1. Interest expense, including amortization of deferred debt issue costs, relating to the 10⅛% Senior Notes totaled approximately $41.7 million, $41.1 million and $41.7 million for 2004, 2003, and 2002, respectively. At December 31, 2004, the fair market value of the $400 million of 10⅛% Senior Notes was approximately $390 million. These notes have not been listed on any securities exchange or inter-dealer automated quotation system, so the estimated market value is based on indicative pricing published by investment banks. While the Company believes these approximations to be reasonably accurate at the time published, indicative pricing can vary widely depending on volume traded by any given investment bank and other factors.

As of December 31, 2003, the Company's wholly owned subsidiary Time Warner Telecom Holdings, Inc. ("Holdings") maintained a senior secured credit facility with lender commitments of $800 million, of which $420 million had been drawn and $396 million was outstanding. Interest expense, including commitment fees and amortization and write-off of deferred debt issue costs, relating to the credit facility totaled approximately $11.8 million and $21.7 million for 2004 and 2003, respectively. On February 20, 2004, Holdings issued $440 million in Senior Notes, repaid the outstanding indebtedness of $396 million under the credit facility, terminated the facility, and entered into a new $150 million Senior Secured Revolving Credit Facility (the "Revolver"), which is currently undrawn. Significant terms and components of the financing are detailed below:

- The $240 million principal amount of Second Priority Senior Secured Floating Rate Notes due February 15, 2011 (the "2011 Notes") are secured obligations, on a second lien basis, of Holdings. The 2011 Notes are guaranteed by the Company and its and Holdings' subsidiaries. The amount of guarantee attributable to any one subsidiary is subject to a maximum that is equivalent to 20% of the outstanding principal balance of the 2011 Notes. Interest is computed based on a specified LIBOR rate plus 4.0% and is reset and payable quarterly. Based on the LIBOR rate in effect as of December 31, 2004, the rate was 6.29% and interest expense including amortization of deferred debt issuance costs was $12.1 million for the year ended December 31, 2004, including amortization of deferred debt issuance costs relating to the 2011 Notes. At December 31, 2004, the fair market value of the $240 million of 2011 Notes was approximately $242 million. These notes have not been listed on any securities exchange or inter-dealer automated quotation system, so the estimated market value is based on indicative pricing published by investment banks. While the Company believes these approximations to be reasonably accurate at the time published, indicative pricing can vary widely depending on volume traded by any given investment bank and other factors.
- The $200 million principal amount of 9 ¼% Senior Notes due February 15, 2014 (the "2014 Notes") are unsecured, unsubordinated obligations of Holdings. The 2014 Notes are subject to similar guarantees as the 2011 Notes, except that the guarantees are unsecured. Interest is payable semi-annually on February 15 and August 15. The notes are guaranteed by the Company and its and Holdings' subsidiaries. Interest expense including amortization of deferred debt issuance costs relating to the 2014 Notes was $16.4 million for the year ended December 31, 2004. At December 31, 2004, the fair market value of the $200 million of 2014 Notes was approximately $203 million. These notes have not been listed on any securities exchange or inter-dealer automated quotation system, so the estimated market value is based on indicative pricing published by investment banks. While the Company believes these approximations to be reasonably accurate at the time published, indicative pricing can vary widely depending on volume traded by any given investment bank and other factors.
- The $150 million Revolver is fully available on a revolving basis and expires on February 20, 2009, or April 14, 2008 if the 9¾% Senior Notes remain outstanding on that date. Holdings is the borrower under the facility and the Company and its subsidiaries and Holdings' subsidiaries are guarantors. Interest is calculated based on a specified Eurodollar rate plus 2 ¼% to 3%. If the Revolver were drawn, certain restrictive financial covenants would apply. The Company is required to pay commitment fees on a quarterly basis of 0.5% per annum on the undrawn available commitment of the Revolver. Commitment fee expense was $1.1 million for the year ended December 31, 2004, including $415,000 of expense related to the terminated credit facility, and has been classified as a component of interest expense in the accompanying consolidated statements of operations.

The Senior Notes are governed by indentures that contain certain restrictive covenants. These restrictions affect, and in many respects significantly limit or prohibit, among other things, the ability of the Company to incur indebtedness, make prepayments of certain indebtedness, pay dividends, make investments, engage in transactions with stockholders and affiliates, issue capital stock of subsidiaries, create liens, sell assets, and engage in mergers and consolidations.

As of December 31, 2004, the Company was in compliance with all of its covenants.

4. Related Party Transactions

In the normal course of business, the Company engages in various transactions with affiliates of the Class B Stockholders, generally on negotiated terms among the numerous affected operating units that, in management's view, result in reasonable arms-length terms.

The Company benefits from its relationship with Time Warner Cable, an affiliate of Time Warner, both through access to local rights-of-way and construction cost sharing. The Company has similar arrangements with Bright House Networks LLC ("Bright House"), an affiliate of Advance/Newhouse, that manages certain cable systems in Florida and Indiana. Twenty-three of the Company's 44 markets use fiber capacity licensed from Time Warner Cable or Bright House (the "Cable Operations"). Under the terms of those agreements, if the Company wishes to license fiber capacity in addition to the capacity initially licensed in 1998, the Company must pay the Cable Operations an amount equal to the Company's allocable share of the total cost of constructing the route in question, plus permitting and supervision fees as a license fee. The Company pays the license fee at the time the network is constructed. Under those agreements, the Company licenses discrete fibers and attaches its own electronics so that the Company's networks are functionally separate from the licensor's. Pursuant to the licensing arrangements, the Company paid the Cable Operations $2.6 million, $4.0 million, and $3.1 million in 2004, 2003, and 2002, respectively, and entered into a capital lease agreement of $1.5 million during the second quarter of 2004. These fees are capitalized to property, plant, and equipment and amortized over their useful lives as depreciation and amortization expense. As of December 31, 2004, the Company's property, plant, and equipment included $188.1 million in licenses of fiber capacity pursuant to the agreements.

Under the licensing arrangement, the Company reimburses the Cable Operations for facility maintenance and pole and conduit rental costs. The reimbursements to the Cable Operations aggregated $4.7 million, $3.7 million, and $3.0 million in 2004, 2003, and 2002, respectively, and are a component of operating expenses in the consolidated statements of operations. In certain cases the Company's operations are co-located with the Cable Operations facilities and are allocated a charge for various overhead expenses. Under the terms of leases and subleases between the Company and the Cable Operations, allocations for rent from the Cable Operations are typically based on square footage and allocations for utility charges are based on actual usage. These charges aggregated $2.2 million, $1.9 million and $1.6 million in 2004, 2003, and 2002 respectively, and are a component of selling, general, and administrative expenses in the consolidated statements of operations. The charges by these affiliates for rent and utilities do not differ materially from charges the Company incurs in locations where the Company leases space from unaffiliated parties.

In 2002, the Company provided technical expertise to Time Warner Cable in conjunction with certain product development and trial efforts conducted by Time Warner Cable, and received $1.0 million in cost reimbursement from Time Warner Cable for such services. The reimbursement was accounted for as an offset to operating and selling, general, and administrative expenses in 2002.

Affiliates of the Class B Stockholders purchase services from the Company. Revenue from these affiliates, which includes dedicated transport services, switched services, and data and Internet services, aggregated $19.9 million, $33.4 million, and $31.8 million for 2004, 2003, and 2002, respectively.

5. Income Taxes

Income tax expense for the years ended December 31, 2004, 2003, and 2002 is as follows:

	2004	2003	2002
	(amounts in thousands)		
Current:			
Federal	$ —	—	—
State	636	1,021	600
	636	1,021	600
Deferred:			
Federal	—	—	—
State	—	—	—
	—	—	—
Total	$636	1,021	600

Total income tax expense differed from the amounts computed by applying the federal statutory income tax rate of 35% to earnings (loss) before income taxes as a result of the following items for the years ended December 31, 2004, 2003, and 2002:

	2004	2003	2002
Federal statutory income tax expense (benefit)	(35.0)%	(35.0)%	(35.0)%
State income tax expense (benefit), net of federal income tax expense (benefit)	(5.1)	0.7	(3.4)
Change in valuation allowance	40.3	35.1	38.4
Other	0.3	0.4	0.1
Income tax expense	0.5%	1.2%	0.1%

The tax effects of temporary differences that give rise to significant components of the Company's deferred tax assets and liabilities at December 31, 2004 and 2003 are as follows:

	2004	2003
	(amounts in thousands)	
Current deferred tax assets (liabilities):		
Accrued liabilities	$ 22,860	27,887
Allowance for doubtful accounts	3,611	9,809
Deferred revenue	10,093	11,439
Other	(8)	(823)
Valuation allowance	(24,046)	(25,898)
Current deferred tax asset net	12,510	22,414
Non-current deferred tax assets (liabilities):		
Depreciation and amortization	(75,064)	(95,497)
Unrealized gains	—	(267)
Net operating loss carryforwards	330,545	278,752
Valuation allowance	(209,214)	(146,928)
Non-current deferred tax asset net	46,267	36,060
Net deferred tax asset	$ 58,777	58,474

At December 31, 2004, the Company had net operating loss carryforwards, for federal income tax purposes of approximately $856.9 million. These net operating loss carryforwards, if not utilized to reduce taxable income in future periods, will expire in various amounts beginning in 2019 and ending in 2024.

In 2002, the Company began to establish a valuation allowance for deferred taxes that reduced its net deferred tax asset. The additional allowance recorded was $60.4 million and $32.3 million for 2004 and 2003 respectively. As of December 31, 2004, net deferred tax assets totaled $58.8 million. The Company has concluded that it is more likely than not that the net deferred tax asset of $58.8 million will be realized because it could utilize tax-planning strategies to realize this amount. However, the Company believes there may be risks in realizing amounts in excess of the $58.8 million through utilization of available tax planning strategies. Accordingly, the Company has established a valuation allowance for amounts in excess of $58.8 million. The Company's treatment of deferred taxes and its tax planning strategies are based on certain assumptions that the Company believes are reasonable. However, actual results could vary significantly from current assumptions and could result in changes to the accounting treatment of these items, including, but not limited to, the necessity to record a greater valuation allowance.

6. Option Plans – Common Stock and Stock Options

Time Warner Telecom 1998 Employee Stock Option Plan

The Company maintains an employee stock option plan that reserved 9,027,000 shares of Class A common stock to be issued to officers and eligible employees under terms and conditions to be set by the Company's Board of Directors. As of December 31, 2004, approximately 5.6 million shares are reserved for issuance upon exercise of outstanding options and approximately 1.2 million shares are available for grant under the Time Warner Telecom 1998 Employee Stock Option Plan. Generally, the options vest over periods of up to four years and expire ten years from the date of issuance. These options have generally been granted to employees of the Company at an estimated fair value at the date of grant, and accordingly, no compensation cost has been recognized by the Company relating to this option plan.

Time Warner Telecom 2000 Employee Stock Plan

The Company maintains an employee stock plan that reserved 24,500,000 shares of Class A common stock to be issued pursuant to stock options and stock awards granted to officers, directors, and eligible employees under terms and conditions to be set by the Company's Board of Directors. As of December 31, 2004, approximately 13.6 million shares are reserved for issuance upon exercise of outstanding options and approximately 10.1 million shares are available for grant under the Time Warner Telecom 2000 Employee Stock Plan. Generally, the options vest over periods of up to four years and expire ten years from the date of issuance. These options have generally been granted to employees of the Company at market value of the underlying stock at the date of grant, and accordingly, no compensation cost has been recognized by the Company relating to these options.

During 1999, the Company granted options to purchase 100,000 shares outside of the option plan. Deferred compensation expense of $2.1 million was recorded and was amortized on a straight-line basis over the four-year vesting period. In each of the years ending December 31, 2003 and 2002, stock compensation expense of approximately $438,000, and $525,000, respectively, was recorded for such options and has been reported as a component of selling, general, and administrative expenses in the accompanying consolidated statements of operations. No expense was recognized in 2004 for such options as these options were fully amortized in 2003.

During 2001, the Company granted restricted stock awards aggregating 275,000 shares to certain officers of the Company. Deferred compensation of $4.0 million was recorded and is being amortized on a straight-line basis over the four-year vesting period. In 2004, 2003 and 2002, stock compensation expense of approximately $1.0 million was recorded in each year for such stock awards and is reported as a component of selling, general, and administrative expenses in the accompanying consolidated statements of operations.

During 2002, the Company granted a restricted stock award for 25,000 shares to an officer of the Company. Deferred compensation of $128,000 was recorded and is being amortized on a straight line basis over the four-year vesting period. In 2004, 2003 and 2002, stock compensation expense of approximately $32,000, $32,000, and $18,000, respectively, was recorded for such stock awards and is reported as a component of selling, general, and administrative expense in the accompanying consolidated statements of operations.

During 2004, the Company granted a performance contingent restricted stock award for 95,000 shares to certain officers of the Company. In 2004, stock compensation expense of approximately $120,000 was recorded for such stock awards and is reported as a component of selling, general, and administrative expense in the accompanying consolidated statements of operations.

The table below summarizes the Company's stock option activity and related information for the years ended December 31, 2004, 2003, and 2002.

	2004		2003		2002	
	Options	Weighted Avg Exercise Price	Options	Weighted Avg Exercise Price	Options	Weighted Avg Exercise Price
Options outstanding at beginning of year	18,634,561	$20.34	17,368,223	$22.91	14,369,786	$32.16
Granted	2,442,168	5.87	2,658,154	7.30	5,069,566	2.51
Exercised	(229,816)	2.98	(214,489)	3.76	(9,940)	11.93
Forfeited	(1,623,291)	19.03	(1,177,327)	31.92	(2,061,189)	37.21
Options outstanding at end of year	19,223,622	18.75	18,634,561	20.34	17,368,223	22.91
Exercisable at end of year	12,870,733	24.87	10,462,684	27.66	7,160,686	29.46

Exercise prices for options outstanding and exercisable as of December 31, 2004, are as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Avg Remaining Contractual Life	Weighted Avg Exercise Price	Number Exercisable	Weighted Avg Exercise Price
$ 0.76—1.99	3,388,467	7.87	$ 1.84	1,735,251	$ 1.84
2.03—7.25	4,387,490	8.56	5.37	1,277,042	5.45
7.32—12.00	4,032,148	4.96	11.24	3,009,897	11.70
12.17—27.00	2,348,740	6.69	16.26	1,841,781	16.51
27.18—87.00	5,066,777	5.40	48.79	5,006,762	48.80
	19,223,622	6.62	18.75	12,870,733	24.87

7. Commitments and Contingencies

The Company leases office space and furniture, switching facilities, and fiber optic use rights. Certain of these leases contain renewal clauses.

At December 31, 2004, commitments under capital and non-cancelable operating leases and maintenance agreements with terms in excess of one year were as follows:

	Capital Leases	Operating Leases	Fixed Maintenance Obligations
	(amounts in thousands)		
Year ended December 31:			
2005	$ 2,541	27,547	3,387
2006	2,507	24,619	3,387
2007	1,079	21,790	3,387
2008	1,079	19,784	3,387
2009	1,079	18,107	3,387
Thereafter	9,975	94,617	51,345
Total minimum lease payments	$18,260	206,464	68,280
Less amount representing interest	7,676		
Present value of obligations under capital leases	10,584		
Less current portion of obligations under capital leases	1,387		
Obligations under capital leases, excluding current portion	$ 9,197		

As of December 31, 2004 and 2003, assets under capital lease obligations, which primarily consist of fiber optic network components, were $12.5 million and $16.6 million, respectively, with related accumulated depreciation of $4.3 million and $9.4 million, respectively. Depreciation expense related to assets under capital lease obligations were $1.6 million, $2.0 million, and $4.4 million in 2004, 2003, and 2002, respectively. The obligations under capital leases have been discounted at an average imputed interest rate of 10.6%. Rental expense under operating leases aggregated $34.4 million, $34.1 million, and $33.6 million for 2004, 2003, and 2002, respectively.

Pending legal proceedings are substantially limited to litigation incidental to the business of the Company. In the opinion of management, the ultimate resolution of these matters will not have a material adverse effect on the Company's financial statements.

Management routinely reviews the Company's exposure to liabilities incurred in the normal course of its business operations. Where a probable contingency exists and the amount of the loss can be reasonably estimated, the Company records the estimated liability. Considerable judgment is required in analyzing and recording such liabilities, and actual results could vary from the estimates.

8. Employee Benefit Plans

Effective January 1, 1999, the Company adopted the Time Warner Telecom 401(k) Plan (the "401(k) Plan"). Employees who meet certain eligibility requirements may contribute up to 60% of their eligible compensation, subject to statutory limitations, to a trust for investment in several diversified investment choices, as directed by the employee. The Company makes a matching contribution of 100% of each employee's contribution up to a maximum of 5% of the employee's eligible compensation. Contributions to the 401(k) Plan aggregated $6.4 million, $5.8 million, and $6.5 million for 2004, 2003 and 2002, respectively.

Effective January 1, 2000, the Company adopted the Time Warner Telecom 2000 Qualified Stock Purchase Plan (the "2000 Stock Purchase Plan"). Employees who met certain eligibility requirements could elect to designate up to 15% of their eligible compensation, up to an annual limit of $25,000, to purchase shares of the Company's Class A common stock at a 15% discount to fair market value. Stock purchases occurred semi-annually, with the price per share equaling the lower of 85% of the market price at the beginning or end of the offering period. The Company was authorized to issue a total of 750,000 shares of the Company's Class A common stock over a period of five years to participants in the 2000 Stock Purchase Plan. As of December 31, 2004, 2003 and 2002, the Company had issued 200,000, 150,000, and 166,576 shares of Class A common stock under the 2000 Stock Purchase Plan for net proceeds of $963,000, $285,000 and $222,000, respectively. The remaining 42,275 shares authorized for the 2000 Stock Purchase Plan but unissued expired on September 30, 2004.

Effective October 1, 2004, the Company adopted the Time Warner Telecom 2004 Qualified Stock Purchase Plan (the "2004 Stock Purchase Plan"). This plan is similar to the 2000 Stock Purchase Plan with respect to eligibility and the purchase price for semi-annual purchases. The Company is authorized to issue a total of 600,000 shares of the Company's Class A common stock over a period of three years to participants in the 2004 Stock Purchase Plan. As of December 31, 2004, no shares had been issued under the 2004 Stock Purchase Plan.

9. Quarterly Results of Operations (Unaudited)

The following summarizes the Company's unaudited quarterly results of operations for 2004 and 2003:

	Three Months Ended (amounts in thousands, except per share amounts)			
	March 31	June 30	September 30	December 31
Year Ended December 31, 2004				
Total revenue	$161,649	162,826	160,588	168,024
Operating income (loss)	(4,793)	634	(3,148)	(9,896)
Net loss	(38,831)	(27,158)	(30,903)	(36,145)
Basic and diluted loss per common share	$ (0.34)	(0.23)	(0.27)	(0.31)
Year Ended December 31, 2003				
Total revenue	$165,013	162,772	172,428	169,378
Operating income (loss)	(5,444)	(4,201)	18,227	(142)
Net loss before cumulative effect of change in accounting principle	(30,384)	(29,001)	(5,658)	(21,328)
Net loss	$ (33,349)	(29,001)	(5,658)	(21,328)
Basic and diluted loss per common share before cumulative effect of change in accounting principle	(0.26)	(0.25)	(0.05)	(0.19)

The total net loss per share for the 2004 and 2003 quarters do not equal net loss per share for the respective years as the per share amounts for each quarter and for each year are computed based on their respective discrete periods.

10. Supplemental Guarantor Information

On February 20, 2004, Holdings ("Issuer") issued $440 million in Senior Notes consisting of $240 million principal amount of Second Priority Senior Secured Floating Rate Notes due 2011, and $200 million principal amount of 9¼% Senior Notes due 2014. These notes are guaranteed by the Company ("Parent Guarantor") and its subsidiaries and Holdings' subsidiaries ("Combined Subsidiary Guarantors"). The guarantees are joint and several. A significant amount of the Issuer's cash flow is generated by the Combined Subsidiary Guarantors. As a result, funds necessary to meet the Issuer's debt service obligations are provided in large part by distributions or advances from the Combined Subsidiary Guarantors. Under certain circumstances, contractual and legal restrictions as well as the Company's financial condition and operating requirements and those of the Company's subsidiaries could limit the Issuer's ability to obtain cash for the purpose of meeting its debt service obligations, including the payment of principal and interest on the 2011 and 2014 Notes.

The following information sets forth the Company's Condensed Consolidating Balance Sheets as of December 31, 2004 and 2003, Condensed Consolidating Statements of Operations for the years ended December 31, 2004, 2003, and 2002 and Condensed Consolidating Statements of Cash Flows for the years ended December 31, 2004, 2003, and 2002.

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING BALANCE SHEET

December 31, 2004

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
ASSETS					
Current assets:					
Cash and cash equivalents	$ 152	130,661	(761)	—	130,052
Investments	23,834	278,620	—	—	302,454
Receivables, net	—	66	45,491	—	45,557
Prepaid expenses and other current assets	2,828	7,765	2,495	—	13,088
Deferred income taxes	5,685	6,825	—	—	12,510
Total current assets	32,499	423,937	47,225	—	503,661
Property, plant and equipment, net	—	46,497	1,256,595	—	1,303,092
Deferred income taxes	14,642	31,625	—	—	46,267
Goodwill	—	—	26,773	—	26,773
Other assets, net of accumulated amortization	11,478	13,181	1,136	—	25,795
Total assets	$ 58,619	515,240	1,331,729	—	1,905,588
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)					
Current liabilities:					
Accounts payable	$ —	1,891	40,613	—	42,504
Other current liabilities	35,241	44,481	159,514	—	239,236
Intercompany payable (receivable)	(1,886,573)	29,672	1,856,901	—	—
Total current liabilities	(1,851,332)	76,044	2,057,028	—	281,740
Losses in subsidiary in excess of investment	742,793	345,438	—	(1,088,231)	—
Long-term debt and capital lease obligations	800,000	440,915	8,282	—	1,249,197
Other long-term liabilities	—	—	7,493	—	7,493
Stockholders' equity (deficit)	367,158	(347,157)	(741,074)	1,088,231	367,158
Total liabilities and stockholders' equity (deficit)	$ 58,619	515,240	1,331,729	—	1,905,588

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2003

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
ASSETS					
Current assets:					
Cash and cash equivalents	$ 10,959	342,216	(143)	—	353,032
Investments	14,172	111,389	—	—	125,561
Receivables, net	49	123	42,797	—	42,969
Prepaid expenses and other current assets	1,300	6,312	2,899	—	10,511
Deferred income taxes	17,322	5,092	—	—	22,414
Total current assets	43,802	465,132	45,553	—	554,487
Property, plant and equipment, net	—	64,323	1,298,924	—	1,363,247
Deferred income taxes	2,845	33,215	—	—	36,060
Goodwill	—	—	26,773	—	26,773
Other assets, net of accumulated amortization	14,705	9,470	1,141	—	25,316
Total assets	$ 61,352	572,140	1,372,391	—	2,005,883
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)					
Current liabilities:					
Accounts payable	$ —	1,137	38,959	—	40,096
Other current liabilities	34,916	41,885	180,792	—	257,593
Intercompany payable (receivable)	(1,882,049)	134,509	1,747,540	—	—
Current portion debt and capital lease obligations	—	58	467	—	525
Total current liabilities	(1,847,133)	177,589	1,967,758	—	298,214
Losses in subsidiary in excess of investment	610,686	280,524		(891,210)	—
Long-term debt and capital lease obligations	800,000	396,563	6,820	—	1,203,383
Other long-term liabilities	—	—	6,487	—	6,487
Stockholders' equity (deficit)	497,799	(282,536)	(608,674)	891,210	497,799
Total liabilities and stockholders' equity (deficit)	$ 61,352	572,140	1,372,391	—	2,005,883

TIME WARNER TELECOM INC.

NOTES TO CONSOLIDATED AND CONDENSED FINANCIAL STATEMENTS—(Continued)

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended December 31, 2004

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
Total revenue	$ —	—	653,087	—	653,087
Costs and expenses:					
Operating, selling, general and administrative	—	123,195	316,407	—	439,602
Depreciation, amortization and accretion	—	28,744	201,944	—	230,688
Corporate expense allocation	—	(151,939)	151,939	—	—
Total costs and expenses	—	—	670,290	—	670,290
Operating loss	—	—	(17,203)	—	(17,203)
Interest expense, net	(81,485)	(29,085)	(5,338)	—	(115,908)
Interest expense allocation	80,775	29,085	(109,860)	—	—
Investment gain	710	—	—	—	710
Loss before income taxes and equity in undistributed losses of subsidiaries	—	—	(132,401)	—	(132,401)
Income tax expense	186	450	—	—	636
Net loss before equity in undistributed losses of subsidiaries	(186)	(450)	(132,401)	—	(133,037)
Equity in undistributed losses of subsidiaries	(132,851)	(64,171)	—	197,022	—
Net loss	$(133,037)	(64,621)	(132,401)	197,022	(133,037)

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended December 31, 2003

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
Total revenue	$ —	—	669,591	—	669,591
Costs and expenses:					
Operating, selling, general and administrative	—	125,072	312,175	—	437,247
Depreciation, amortization and accretion	—	32,563	191,341	—	223,904
Corporate expense allocation	—	(157,635)	157,635	—	
Total costs and expenses	—	—	661,151	—	661,151
Operating income	—	—	8,440	—	8,440
Interest expense, net	(80,564)	(13,160)	(4,060)	—	(97,784)
Interest allocation	76,570	13,160	(89,730)	—	
Investment losses, net	3,994	—	—	—	3,994
Loss before income taxes and equity in undistributed losses of subsidiaries	—	—	(85,350)	—	(85,350)
Income tax expense	—	975	46		1,021
Net loss before equity in undistributed losses of subsidiaries and cummulative effect of change in accounting principle	—	(975)	(85,396)	—	(86,371)
Equity in undistributed losses of subsidiaries	(89,336)	(37,998)	—	127,334	—
Net loss before cumulative effect of change in accounting principle	(89,336)	(38,973)	(85,396)	127,334	(86,371)
Cumulative effect of change in accounting principle	—	—	2,965	—	2,965
Net loss	$(89,336)	(38,973)	(88,361)	127,334	(89,336)

TIME WARNER TELECOM INC.

NOTES TO CONSOLIDATED AND CONDENSED FINANCIAL STATEMENTS—*(Continued)*

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Year Ended December 31, 2002

	Parent Guarantor	Issuer	Combined Subsidiary Guarantor	Eliminations	*Consolidated*
			(amounts in thousands)		
Total revenue	$ —	—	695,574	—	695,574
Costs and expenses:					
Operating, selling, general and administrative	—	133,352	373,006	—	506,358
Depreciation and amortization	—	45,510	191,800	—	237,310
Corporate expense allocation	—	(178,862)	178,862	—	—
Impairment of assets	—	—	212,667	—	212,667
Total costs and expenses	—	—	956,335	—	956,335
Operating loss	—	—	(260,761)	—	(260,761)
Interest expense, net	(81,891)	(20,974)	1,431	—	(101,434)
Interest allocation	85,131	20,974	(106,105)	—	—
Investment losses, net	(3,240)	—	—	—	(3,240)
Loss before income taxes and equity in undistributed losses of subsidiaries	—	—	(365,435)	—	(365,435)
Income tax expense	—	600	—	—	600
Net loss before equity in undistributed losses of subsidiaries	—	(600)	(365,435)	—	(366,035)
Equity in undistributed losses of subsidiaries	(366,035)	(208,649)	—	574,684	—
Net loss	$(366,035)	(209,249)	(365,435)	574,684	(366,035)

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2004

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
Cash flows from operating activities:					
Net loss	$(133,037)	(64,621)	(132,401)	197,022	(133,037)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation, amortization, and accretion	—	28,744	201,944	—	230,688
Intercompany change	(3,360)	(104,837)	305,219	(197,022)	—
Amortization and impairment of deferred debt issue costs	2,391	10,463	—	—	12,854
Investment gains, net	(710)	—	—	—	(710)
Stock based compensation	—	—	1,164	—	1,164
Changes in operating assets and liabilities	131,170	62,379	(217,967)	—	(24,418)
Net cash (used in) provided by operating activities	(3,546)	(67,872)	157,959	—	86,541
Cash flows from investing activities:					
Capital expenditures	—	(8,418)	(159,411)	—	(167,829)
Purchases of investments	(37,862)	(509,086)	—	—	(546,948)
Proceeds from maturities of investments	28,200	344,955	—	—	373,155
Other investing activities	752	—	2,100	—	2,852
Net cash used in investing activities	(8,910)	(172,549)	(157,311)	—	(338,770)
Cash flows from financing activities:					
Net proceeds from issuance of debt	—	425,858	—	—	425,858
Repayment of debt	—	(396,000)	—	—	(396,000)
Net proceeds from issuance of common stock upon exercise of stock options	686	—	—	—	686
Net proceeds from issuance of common stock in connection with the employee stock purchase plan	963	—	—	—	963
Payment of capital lease obligations	—	(992)	(1,266)	—	(2,258)
Net cash provided by (used in) financing activities	1,649	28,866	(1,266)	—	29,249
Decrease in cash and cash equivalents	(10,807)	(211,555)	(618)	—	(222,980)
Cash and cash equivalents at beginning of year	10,959	342,216	(143)	—	353,032
Cash and cash equivalents at end of year	$ 152	130,661	(761)	—	130,052

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2003

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
Cash flows from operating activities:					
Net loss	$ (89,336)	(38,973)	(88,361)	127,334	(89,336)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation, amortization, and accretion	—	32,563	191,341	—	223,904
Intercompany change	100,072	3,923	23,339	(127,334)	—
Amortization of deferred debt issue costs	2,392	2,122	—	—	4,514
Cumulative effect of change in accounting principle	—	—	2,965	—	2,965
Investment gains, net	(3,994)	—	—	—	(3,994)
Stock based compensation	—	—	1,481	—	1,481
Changes in operating assets and liabilities, net of the effect of acquisitions	(15,804)	10,612	(10,721)	—	(15,913)
Net cash (used in) provided by operating activities	(6,670)	10,247	120,044	—	123,621
Cash flows from investing activities:					
Capital expenditures	—	(14,867)	(114,830)	—	(129,697)
Purchases of investments	(23,295)	(237,213)	—	—	(260,508)
Proceeds from maturities of investments	9,123	125,824	—	—	134,947
Proceeds from sale of assets	4,397	—	176	—	4,573
Net cash used in investing activities	(9,775)	(126,256)	(114,654)	—	(250,685)
Cash flows from financing activities:					
Repayment of debt	—	(24,000)	—	—	(24,000)
Net proceeds from issuance of common stock upon exercise of stock options	2,287	—	(1,481)	—	806
Net proceeds from issuance of common stock in connection with the employee stock purchase plan	285	—	—	—	285
Payment of capital lease obligations	—	(32)	(3,423)	—	(3,455)
Net cash provided by (used in) financing activities	2,572	(24,032)	(4,904)	—	(26,364)
(Decrease) increase in cash and cash equivalents	(13,873)	(140,041)	486	—	(153,428)
Cash and cash equivalents at beginning of year	24,832	482,257	(629)	—	506,460
Cash and cash equivalents at end of year	$ 10,959	342,216	(143)	—	353,032

TIME WARNER TELECOM INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
Year Ended December 31, 2002

	Parent Guarantor	Issuer	Combined Subsidiary Guarantors	Eliminations	Consolidated
			(amounts in thousands)		
Cash flows from operating activities:					
Net loss	$(366,035)	(209,249)	(365,435)	574,684	(366,035)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization	—	45,510	191,800	—	237,310
Intercompany change	347,224	192,324	35,136	(574,684)	—
Amortization and impairment of deferred debt issue costs	2,392	4,134	—	—	6,526
Impairment of assets related to restructure charge	—	—	(694)	—	(694)
Investment losses, net	3,240	—	—	—	3,240
Stock based compensation	—	—	1,595	—	1,595
Impairment of assets	—	—	212,667	—	212,667
Changes in operating assets and liabilities	37,644	(71,863)	1,176	—	(33,043)
Net cash provided by (used in) operating activities	24,465	(39,144)	76,245	—	61,566
Cash flows from investing activities:					
Capital expenditures	—	(28,932)	(75,899)	—	(104,831)
Purchases of investments	—	(8,546)	—	—	(8,546)
Proceeds from maturities of investments	—	27,000	—	—	27,000
Proceeds from sale of assets	—	—	2,412	—	2,412
Net cash used in investing activities	—	(10,478)	(73,487)	—	(83,965)
Cash flows from financing activities:					
Net proceeds from issuance of debt	—	216,770	—	—	216,770
Repayment of debt	—	(50,000)	—	—	(50,000)
Net proceeds from issuance of common stock upon exercise of stock options	145	—	—	—	145
Net proceeds from issuance of common stock in connection with the employee stock purchase plan	222	—	—	—	222
Payment of capital lease obligations	—	—	(3,878)	—	(3,878)
Net cash provided by (used in) financing activities	367	166,770	(3,878)	—	163,259
Increase (decrease) in cash, cash equivalents, and cash held in escrow	24,832	117,148	(1,120)	—	140,860
Cash and cash equivalents at beginning of year	—	365,109	491	—	365,600
Cash and cash equivalents at end of year	$ 24,832	482,257	(629)	—	506,460

11. Subsequent Event

On February 9, 2005, the Company's wholly-owned subsidiary, Time Warner Telecom Holdings Inc. ("Holdings") issued an additional $200 million in 9 1/4% Senior Notes due February 15, 2014 (the "2014 Notes"). The 2014 Notes are unsecured, unsubordinated obligations of Holdings and are guaranteed by the Company and certain of its and Holdings' subsidiaries, subject to certain limits. Proceeds from the financing will be used for future capital expenditures. Immediately following the financing, the Company called for the redemption of $200 million of its 9 3/4% Senior Notes due July 15, 2008. Approximately $210 million of cash on hand was used to redeem $200 million aggregate principal amount at a redemption price of 103 1/4% plus accrued interest.

TIME WARNER TELECOM LLC

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 2004, 2003, and 2002

	Balance at Beginning Of Period	Additions/ Charges to Costs and Expenses	Deductions	Balance at End of Period
		(amounts in thousands)		
For the Year ended December 31, 2004:				
Allowance for doubtful accounts receivable	$15,011	10,754	(14,350)	11,415
For the Year ended December 31, 2003:				
Allowance for doubtful accounts receivable	$21,946	20,605	(27,540)	15,011
For the Year ended December 31, 2002:				
Allowance for doubtful accounts receivable	$29,778	32,469	(40,301)	21,946